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REPORT
No. 97-830

COMPLETED

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APPLICATION OF SECTION 252 OF ECONOMIC RECOVERY TAX ACT OF 1981 TO CERTAIN TRANSFERS IN 1973

SEPTEMBER 16, 1982.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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Mr. ROSTENKOWSKI, from the committee on Ways and Means, submitted the following

REPORT

[To accompany H.R. 4577]

The Committee on Ways and Means, to whom was referred the bill (H.R. 4577) to amend Public Law 97-34, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

Strike our all after the enacting clause and insert in lieu thereof the following:

That (a) IN GENERAL.—Notwithstanding subsection (c) of section 252 of the Economic Recovery Tax Act of 1981, the amendment made by subsection (a) of such section 252 (and the provisions of subsection (b) of such section 252) shall apply to any transfer of stock to any person if——

(1) Such transfer occurred in November or December of 1973 and was pursuant to the exercise of an option granted in November or December of 1971,

(2) in December of 1973 the corporation granting the option was acquired by another corporation in a transaction qualifying as a reorganization under section 368 of the Internal Revenue Code of 1954,

(3) the fair market value (as of July 1, 1974) of the stock received by such person in the reorganization in exchange for the stock transferred to him pursuant to the exercise of such option was less than 50 percent of the fair market value of the stock so received (as of December 4, 1973),

(4) in 1975 or 1976 such person sold substantially all of the stock received in such reorganization, and

(5) such person makes an election under this section at such time and in such manner as the Secretary of the Treasury or his delegate shall prescribe.

(b) LIMITATION ON AMOUNT OF BENEFIT.—Subsection (a) shall not apply to transfers with respect to any employee to the extent that the application of subsection (a) with respect to such employee would (but for this subsection) result in a reduction in liability for income tax with respect to such employee for all taxable years in excess of $100,000 (determined without regard to any interest).

(c) STATUTE OF LIMITATIONS.—

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(1) OVERPAYMENTS.—If refund or credit of any overpayment of tax resulting from the application of subsection (a) is prevented on the date of the enactment of this Act (or at any time within 6 months after such date of enactment) by the operation of any law or rule of law, refund or credit of such overpayment (to the extent attributable to the application of subsection (a)) may, nevertheless, be made or allowed if claim therefor is filed before the close of such 6-month period.

(2) DEFICIENCIES.—If the assessment of any deficiency of tax resulting from the application of subsection (a) is prevented on the date of the enactment of this Act (or at any time within 6 months after such date of enactment) by the operations of any law or rule of law, assessment of such deficiency (to the extent attributable to the application of subsection (a)) may, nevertheless, be made within such 6-month period.

Amend the title so as to read:

A bill to provide that the provisions of section 252 of the Economic Recovery Tax Act of 1981 (relating to transfers of property to employees subject to certain restrictions) shall apply to certain transfers occurring during 1973.

I. SUMMARY

The bill permits certain individuals who received stock in 1973 pursuant to the exercise of employee stock options to elect to have section 252 of the Economic Recovery Stock Act of 1981 apply retroactively in certain limited circumstances. Under the bill, any reduction in tax pursuant to such election could not exceed $100,000 with respect to any one employee. The statute of limitations is amended by the bill to permit refunds or credits, or assessments, attributable to the provisions of the bill.

II. EXPLANATION OF THE BILL

Present Law

In General

Under the present law rules relating to transfers of property in connection with the performance of services (Code sec. 83), an employee generally includes in income the fair market value of transferred property, less any amount paid for the property, when the property first becomes either transferable or not subject to a substantial risk of forefeiture.[1] Thus, if an employee receives property that is both subject to a substantial risk of forfeiture and is not transferable, the employee generally is not taxed until the property becomes either transferable or not subject to a substantial risk of forefeiture. The amount the employee includes in income is equal to the fair market value of the transferred property (as of the time of taxation), less any amount the employee paid for the property.

However, an employee may elect (under sec. 83(b)) to be taxed when the property is received.[2] In that case, the employee includes an amount in income equal to the fair market value of the property when received less any amount paid for the property.

Effect of restrictions

Generally, under section 83, restrictions on property are not taken into account in determining the fair market value of the

[1] An employer generally is allowed a business expense deduction, when the employee is taxed, equal to the amount includible in the employee's income (sec. 83(h)).
[2] See note 1.

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property. Also, property is considered transferable for purposes of section 83 when the property would not be subject to a substantial risk of forfeiture in the hands of a subsequent transferee.

Prior to enactment of section 252 of the Economic Recovery Tax Act of 1981 (ERTA), the U.S. Tax Court had ruled [3] that stock subject to the "insider trading" rules of section 16(b) of the Securities Exchange Act of 1934 [4] was transferable within the meaning of section 83. Thus, although the taxpayer's profit on a sale of the stock within six months of reciept could be recovered by the corporation, the taxpayer was taxable on the fair market value of the stock when received.

As amended by section 252 of ERTA, section 83 provides that stock subject to the restrictions of section 16(b) of the Securities Exchange Act of 1934 is treated as being subject to a substantial risk of forfeiture and nontransferable for the six-month period following receipt of the stock during which that section applies. Thus, unless the taxpayer elects (under sec. 83(b)) to be taxed when the stock is received, the taxpayer must include in income (and the employer may deduct), at the expiration of the period during which section 16(b) is applicable, the value of the stock at such time, less any amount the taxpayer paid for the stock. A similar rule is provided for stock subject to restrictions on transfer by reason of complying with the "pooling-of-interests" accounting rules of Accounting Series Releases Numbered 130 ((10/5/72) 37 FR 20937; 17 CFR 211.130)) and 135 ((1/18/73) 38 FR 1734; CFR 211.135)).

The amendments made to section 83 by section 252 of ERTA apply to taxable years (of the transferee) ending after December 31, 1981.

Reasons for Change

The committee has been advised of a situation in which, prior to the effective date of ERTA section 252, stock acquired by several shareholder employees pursuant to the exercise of an option underwent a substantial diminution in value while both section 16(b) of the Securities Exchange Act of 1934 and the restrictions on transferability to comply with the "pooling-of-interests" accounting rules were in effect. The committee has concluded that in this situation, as under the rules enacted by ERTA, such shareholder employees should not be required to treat as compensation the value of the stock while subject to such limitations.

Explanation of Provisions

Under the bill, the rules of section 252 of ERTA will apply if (1) stock was acquired in November or December of 1973 pursuant to options granted in November or December of 1971, (2) the corporation granting the options was acquired in a reorganization during December 1973, and (3) the fair market value of the stock in the acquiring corporation as of July 1, 1974, received in exchange for the stock acquired on exercise of the option, was less than 50 percent of its value on December 4, 1973. This relief under the bill will

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[3] *Horwith* v. *Comm'r*, 71 T.C. 932 (1979).
[4] 15 U.S.C. sec. 78p(b).

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be allowed only at the election of a shareholder who during 1975 or 1976 sold substantially all the stock so received.

The bill will not apply with respect to a transfer to any employee to the extent that its application would result in a reduction in tax liability (exclusive of interest) of such employee in excess of $100,000 for all taxable years.

Also, the bill provides that a refund or credit of any overpayment of tax, or an assessment of any deficiency, which is attributable to provisions of the bill, and which otherwise would be barred within six months after the date of enactment, may be made or allowed to the extent attributable to application of provisions of the bill, provided that, in the case of a credit or refund, a claim therefor is filed within such six-month period.

The provisions of the bill may affect the tax liability of an electing person for the year in which stock was sold, as well as the amount of compensation and the year of its inclusion in income. The bill may also affect the amount and timing of any deduction allowable to the employer corporation. The statute of limitations is to be kept open for the purpose of making such adjustments.

The intended beneficiaries of this bill are John G. Franzia, Jr., Joseph S. Franzia, and Fred T. Franzia.

Effective Date

The bill will have only retroactive effect, and only to the limited extent provided in the bill and described in the explanation of the provisions of the bill.

III. EFFECT OF THE BILL ON THE BUDGET AND VOTE OF THE COMMITTEE IN REPORTING THE BILL

Budget effects

In compliance with clause 7 of Rule XIII of the Rules of the House of Representatives, the following statement is made about the effect on the budget of this bill, H.R. 4577. The comittee estimates that the provisions contained in the bill, H.R. 4577, as amended will reduce budget receipts by a negligible amount.

The Treasury Department agrees with this statement.

Vote of committee

In compliance with clause 2(l)(2)(B) of Rule XI of the Rules of the House of Representatives, the following statement is made about the vote of the committee on the motion to report the bill, as amended. The bill, H.R. 4577, as amended, was ordered favorably reported by voice vote.

IV. OTHER MATTERS TO BE DISCUSSED UNDER HOUSE RULES

In compliance with clauses 3(l)(3) and 2(l)(4) of Rule XI of the Rules of the House of Representatives, the following statements are made with respect to the committee action on H.R. 4577, as amended.

Oversight findings

With respect to subdivision (A) of clause 2(1)(3) (relating to oversight findings), the committee advises that it was as a result of the committee's oversight activities with respect to the treatment of certain stock options that the committee concluded that it is appropriate to enact the provisions contained in the bill.

The Subcommittee on Select Revenue measures held a hearing on March 16, 1982, and ordered the bill favorably reported on July 12, 1982, with amendments. The Subcommittee transmitted a report to the full committee on September 10, 1982.

New budget authority and tax expenditures

With respect to subdivision (B) of clause 2(l)(3), after consultation with the Director of the Congressional Budget Office, the committee states that the changes made to existing law by this bill involve no new budget authority or new or increased tax expenditures.

Consultation with congressisonal budget officials on budget estimates

With respect to subdivision (C) of clause 2(1)(3), the committee advises that the Director of the Congressional Budget Office has examined the committee's budget estimates (as indicated in part III of this report) and agrees with the committee's budget estimates.

Oversight by Committee on Government Operations

With respect to subdivision (D) of clause 2(l)(3), the commitee advises that no oversight findings or recommendations have been submitted to the committee by the Committee on Government Operations regarding the subject matter of this bill.

Inflationary impact

In compliance with clause 2(l)(4), the committee states that the enactment of this bill is not expected to have an inflationary impact on prices and costs in the operation of the national economy.

V. PROVISIONS OF EXISTING LAW REFERRED TO IN THE BILL, AS REPORTED

For the information of the Members of the House of Representatives, the following provisions of existing law are referred to in the bill, as reported:

SECTION 252 OF THE ECONOMIC RECOVERY TAX ACT OF 1981

SEC. 252. PROPERTY TRANSFERRED TO EMPLOYEES SUBJECT TO CERTAIN RESTRICTIONS.

(a) GENERAL RULE.—Subsection (c) of section 83 (relating to special rules) is amended by adding at the end thereof the following new paragraph:

"(3) SALES WHICH MAY GIVE RISE TO SUIT UNDER SECTION 16(b) OF THE SECURITIES AND EXCHANGE ACT OF 1934.—So long as the

sale of property at a profit could subject a person to suit under section 16(b) of the Securities and Exchange Act of 1934, such person's rights in such property are—

"(A) subject to a substantial risk of forfeiture, and

"(B) not transferable."

(b) SPECIAL RULE FOR CERTAIN ACCOUNTING RULES.—For purposes of section 83 of the Internal Revenue Code of 1954, property is subject to substantial risk of forfeiture and is not transferable so long as such property is subject to a restriction on transfer to comply with the "Pooling-of-Interests Accounting" rules set forth in Accounting Series Release Numbered 130 ((10/5/72) 37 FR 20937; 17 CFR 211.130) and Accounting Series Release Numbered 135 ((1/18/73) 38 FR 1734; 17 CFR 211.135).

(c) EFFECTIVE DATE.—The amendment made by subsection (a) and the provisions of subsection (b) shall apply to taxable years ending after December 31, 1981.

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